

April 6, 1981

LETTER 806

Mar 27, DJIA 994.78; PTI 1433; A-D Ratio -16.48

NOTE: I'm mailing this Letter a few days early because (a) I'm off to LA to speak at the American Economic Council's Conference, (b) I want to take a day off to see my daughter, Betsy, in LA (she's a model and an aspiring actress), and (c) I'm going on a short Cactus collecting trip — my hobby is growing these spiny desert denizens.

THE PICTURE: On March 25 the primary trend of the stock market was re-confirmed as bullish. On that day the D-J Industrial Average closed at 1015.22 and the D-J Transportation Average closed at 433.56. Thus, new high were recorded, and for the first time in four months, BOTH of the two D-J components closed above their November 20, 1980 peaks.

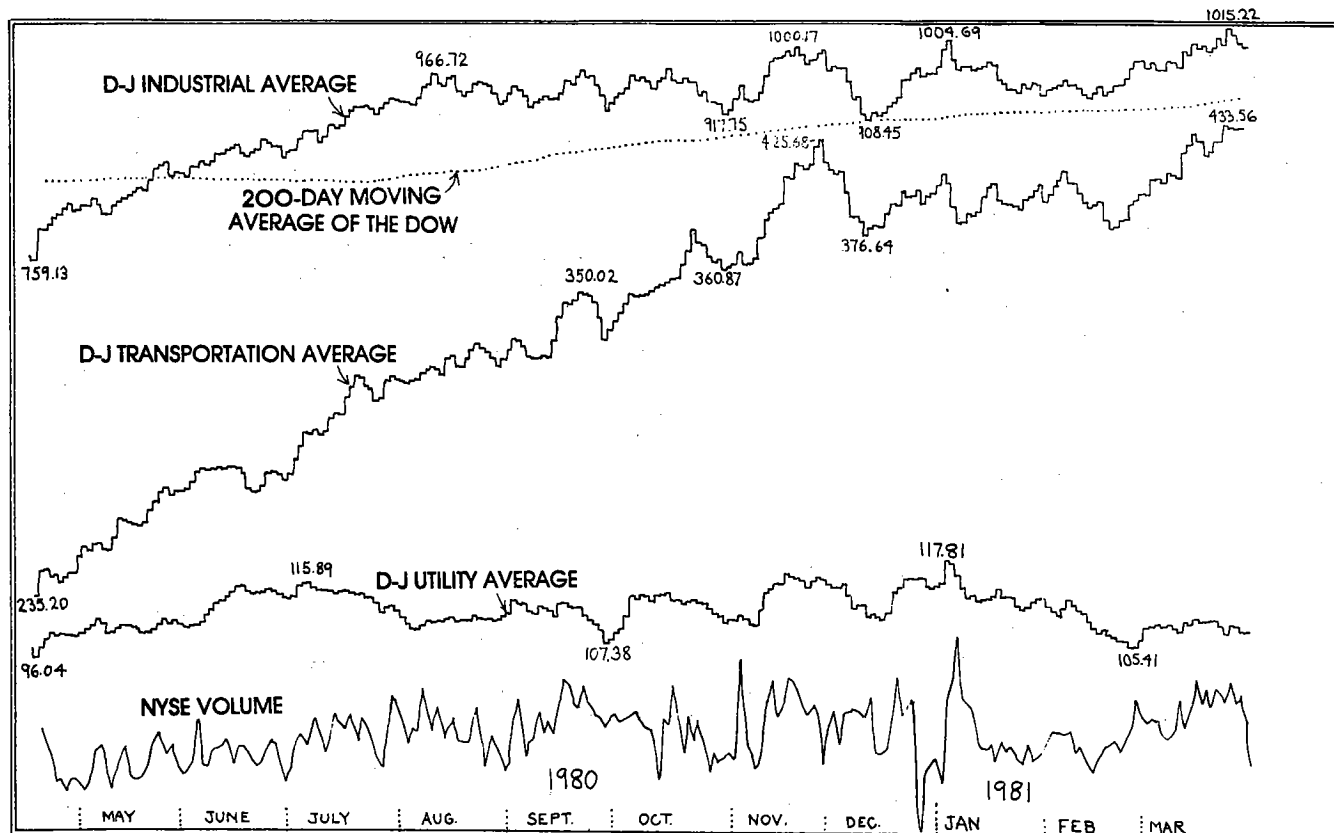
The move was remarkable because it came in the face of a badly lagging advance-decline ratio. The real peak in the A-D ratio occurred at minus 14.85 on September 11, 1978. A second peak came in September, 1980 at minus 15.33. You can see the 1980 peak on the page 2 chart. Thus we have a series of new highs in the Industrial Average while it has been 2½ years since the last major peak in the A-D ratio. This is the longest lag between price (the Dow) and breadth (the A-D ratio) in stock market history, and this drag on the part of the A-D may be the technical aberration which has held the market back for so long. At any rate, it will be most important to see whether the A-D can now advance above its September, 1980 high of minus 15.33 (and preferably above its 1978 high of minus 14.85).

FRONT PAGE COMMENT: The budget deficit for the first 6 months of the new fiscal year (1981) is \$56 billion! The Congressional Budget Office (which has a fairly good record) predicts the 1981 budget deficit at \$63 billion, \$8 billion more than the Reagan Administration's projection. The CBO also projects the 1982 deficit at \$67 billion, \$22 billion above Administration projections. My own guess is that the 1981 and 1982 deficits will be far worse than even the CBO's projections.

I've said before and I'll repeat it. If you want to balance the budget you have to cut *where the spending is*. That means social programs and social security. Those programs, together with high military salaries and pension, are eating this country up alive! The hard part of the Reagan program has not yet begun — and I'm sure it's even been faced. In the mean time, don't bet on a good bond market, and don't bet on a meaningful decline in inflation (if we do get a reversal in inflation, it's going to be a deflationary slump).

It is also notable that so far the major composite averages (the NYSE Index and the Standard & Poor's 500) have failed to follow the Dow to new highs. I drew attention to the lag in these broad indices in the last Letter (see point & figure charts).

The advance-decline line for the 30 Dow stocks has also lagged on this rally, failing over and over again to confirm new highs in the Dow. Technically, it is the discrepancies and divergences between price and the various breadth indices which bother me



most about this market. I've never seen the A-D ratio and the Dow A-D line refuse so stubbornly to confirm strength in the D-J Industrial Average.

The most accurate and certainly the most insistent indicator of market direction throughout the trying period since last November has been the Primary Trend Index (PTI). The page 2 chart tells its own story. Here we see the PTI holding stubbornly above its ascending trendline, with each successive rally taking the PTI to yet another high.

On March 25 the PTI rose to a record high of 1445. It then dropped 12 points to 1433 on March 29, but as of March 31 the PTI was at 1441, only 4 points from its high. The question might be asked, "How could anyone fail to follow a device that is so simple and so seemingly accurate?" The answer is that following the PTI is easy — but believing it is often very difficult.

Question: Obviously, your subscribers and many other readers are now following the PTI. Isn't it possible that too many people are going to end up investing with the PTI, and isn't it also possible that the PTI could make a disastrous error?

Answer: Anything is possible. The PTI is constructed so that it coldly, sans emotions, monitors the underlying build-up (or deterioration) in the market's technical underpinnings. The single danger in using the PTI is that the market might form a "spearpoint top" and then suddenly turn down — and it might do this prior to a bona fide bear signal from the PTI (in other words, the PTI might be late with a bear signal).

Even so, most turns in the market have been accompanied by non-confirmations by the PTI or a string of divergences in the PTI (for instance, the Dow moving to new highs while the PTI trails off).

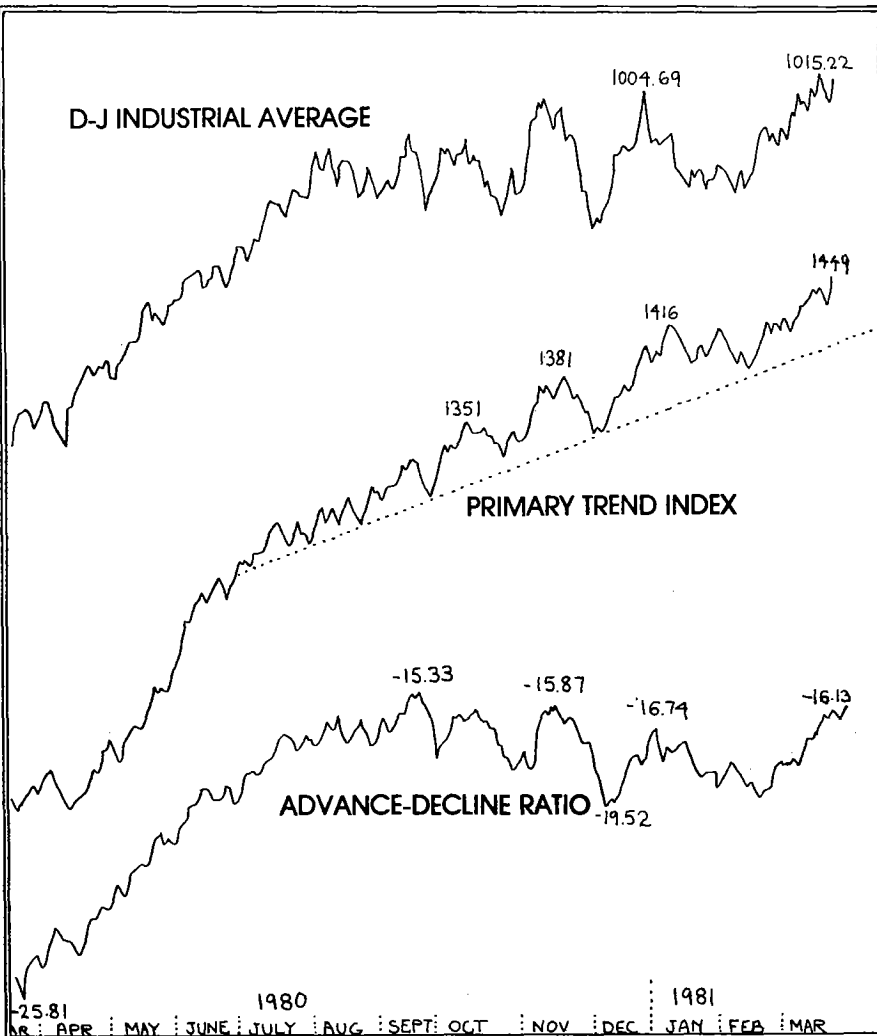
Question: What is the major factor that you watch on the PTI?

Answer: I look for a persistent trend, such as the one we have been seeing since March, 1980. A steady move above a rising trendline tells me that the technical underpinnings of the market are intact or improving. The converse, of course, is true when the PTI holds below a declining trendline.

Question: What do you consider the outstanding attributes of the PTI?

Answer: First, the PTI is generally easy to read. Second, the PTI does not tend to produce whip-saws: for instance, it stayed bearish all during 1973-74, thereby helping me and my subscribers to avoid many a heart-ache. And you can see how the PTI has held consistently bullish during 1980-81. Third, the PTI is a proprietary indicator. No one computes it but Richard Russell, and this is a great advantage. No one sees the PTI but subscribers to these Letters. As I stated in the last report, what everyone follows ceases to be useful as far as making money in Wall Street is concerned.

Question: I note that the lagging A-D ratio continues to bother you, as does the lagging action of the major composite stock



averages. How do you reconcile these problems in the face of the bullish PTI?

Answer: The A-D and composite average performances worry me, but I am going to continue giving most credence to the PTI. The A-D ratio and the lagging composite averages may be saying that there is potential danger in this market — but that danger won't materialize UNTIL the PTI turns decisively down.

INVESTMENT POSITION: The risk/reward equation at this time tells me that I want the bulk of my funds in 91-day Treasury bills. Depending on your own temperament, a portion of your funds can be invested in top no-load funds, and the funds may be retained as long as the PTI holds above its trendline. The "potential top formations" shown in the last Letter and the lagging breadth indices continue to bother me, but maybe I'm just a worry-wart. Gold positions (modest ones) may be assumed as and if gold nears 500. As for the risk/reward in trading gold, remember that at current 12% short-term interest rates, gold has to rally about \$70 to equal the return on T-bills.

I've mentioned many times that an easy way to participate in the market is via the no-load mutual funds. Two excellent funds are *American Investors Fund*, PO Box 2500, Greenwich CT 06830, and *Dreyfus Number 9*, 600 Madison Ave., NYC 10022.

INTEREST RATES: Here are two news clippings. The first (from WSJ, March 27) tells a story that I have been writing about for months. It's about the flood of new money needed by our

Staff Reporters of THE WALL STREET JOURNAL

NEW YORK—Interest rates surged yesterday, sending bond prices into a tailspin as dealers struggled under the weight of a heavy supply of new Treasury securities.

The downward pressure on bond prices accelerated as hopes faded that the Federal Reserve System would continue to relax its credit reins.

"This market has so much supply to deal with that in the absence of any goods news, it's going to retreat,"

said William Griggs,

senior vice presi-

Henry

Credit Markets

Government Finances

WASHINGTON (AP) — Here are figures on government spending and debt (last six digits are omitted). The government's fiscal year runs from Oct. 1 through Sept. 30.

Total public debt March 24	957,221
Interest on public debt Feb	6,990
Interest fiscal year thru Feb	→ 37,119
Projected deficit fiscal 1981	54,894
Projected deficit fiscal 1982	44,961
Actual deficit fiscal 1980	58,990
Receipts fiscal year thru Feb	217,610
Receipts period last year	195,331
Outlays fiscal year thru Feb	273,624
Outlays period last year	233,543
Gold for Jan	11,159

still wild-spending Government. Last week, for some reason, the bond market again "discovered" that the Treasury is going to flood the money markets with new issues. Down went Treasury bonds (again) to near record lows. What do I predict for the rest of 1981 and for 1982? More of the same. President Reagan is pushing to cut \$44 billion from the budget. The figure I would pick is \$100 billion. That would put the budget near balance. The second clip is the latest set of Treasury statistics. Note the interest on the national debt for the 1981 fiscal year so far (5 months so far). The figure is \$37.1 billion. My prediction for total interest expenses for fiscal 1981 is \$92 to \$94 billion. Last year the figure was \$74.8 billion. So this year interest costs will rise an UNBELIEVABLE \$18 billion or \$1.5 billion a month.

Remember what I said about COMPOUNDING deficits and debts! In case you misunderstood, dear readers, I'm not talking about increases in the Federal budget, I'm talking about an \$18 billion increase in just interest on the debt. So....anyone for balancing the budget? No, then buckle your seat belts, people!

Oh yes, interest rates. Well, in my opinion (taking full measure of the way things are going in Washington) I am going to bet that interest rates will stay generally high — with new record high interest rates still possible in 1981.

INVESTING & STRESS: I can't emphasize enough that no amount of profits are worth the loss of your health. That is why I often talk about risk and reward. EVERY investment and speculation exerts a certain toll on the psyche of the transactor. But I have noticed that the average person in his investment dealings tends to produce an unnecessary amount of tension and stress.

Guilt and stress are the two great destroyers of health. I have known many people who felt guilty when they made large amounts of money ("How could it happen to me") and others who felt guilty about inheriting large sums ("I don't deserve it"). These people often get rid of their guilt by getting rid of their money. They get rid of the money by stupid investments, absurd over-trading or even giving the cash away (in the case of wives, often to spendthrift husbands).

Stress is the more common element in the stress/guilt syndrome. Many people (unconsciously) look for stress. They "like" the stress because it takes their minds off their REAL problems such as bad marriages, personal problems, etc. These people get something out of their stress, and they hate to give it up. The most important thing in getting rid of this kind of insane stress is to brutally zero in on what you are actually doing. You have to stop kidding yourself!

I've said this before and I'll repeat it. Add up your investment profits and losses for the year. Then ask yourself if it was worth the stress. If it was, fine — nothing is gained without some kind of stress. But if all your efforts were not worth the stress and pressure involved, re-think what you are doing with your investments. Remember, most funds over a 10 year period average about 10% compounded. You may find yourself experiencing a great deal of stress in your investment and not even getting the 10% (and remember, T-bills are yielding over 12% today).

I can't remove every subscriber's guilt and stress, but I can ask you to stop and think, and then re-think what you are doing in your investment activities. Here are a few rules that I have developed over 35 years of handling my own money:

- (1) Never lose sight of the idea that you are investing to make money. That sounds simple but it isn't. The corollary: Don't invest for thrills. If you do, the odds are that you'll get a lot more thrill than you bargained for.
- (2) Does the investment make sense from a risk/reward standpoint, taxes considered? Remember, it takes a real pro to skip a situation in which he is reasonably sure that the item is going higher in price — yet the risk/reward still does not warrant his taking a position.
- (3) Remember that the market is ALWAYS THERE. There's nothing wrong with missing a move. But there is everything wrong with over-trading and over-investing. Often, it is worthwhile sitting on the sideline just to catch your breath — or to gain perspective. Remember the old market adage, "When in doubt — stay out!"
- (4) Stay off margin. Margin is the guaranteed road to stress. I'm not saying that margin-users don't make money. I'm saying that margin-users invite stress. A short seller borrows stock and then sells that stock short. To that extent he is margined. For 90% of my subscribers, I say, avoid the short side of the market. A few pros know how to make money on the short side, but most people lose money in shorts. Despite what you might hear to the contrary shorting requires an entirely different psychology than going long. Forget shorting!
- (5) Always keep in mind the "magic" of compound interest. Making a fortune with the help of compound interest requires only three things (a) the ability to save, (b) patience, (c) time. Most people have all three, but MOST PEOPLE ARE UNAWARE THAT THEY HAVE ALL THREE.

(6) When you make a mistake admit it to yourself — then act. The two catastrophic procedures in investing are (a) to STAY wrong, and (b) to compound a mistake, for instance, to average down on a stock that is sliding to new lows.

(7) Most important, don't waste time worrying about things that you can't do anything about — or things that you have no intention of doing anything about!

I'm including this excellent little treatise on stress from the April, 1981 *Science Digest*.

RAVAGES OF STRESS

The body's immune system—its primary defense against disease—is itself not immune to the ravages of stress. Prolonged stress may contribute to many diseases, including cancer, by depressing the body's normal immune response.

According to Dr. David Sobell, chief of Preventive Medicine at San Francisco's Kaiser-Permanente Medical Center, stressors can cause changes in the hypothalamus, a tiny region of the brain that stimulates hormone secretion from the pituitary—sometimes called the master gland—and other glands. The hypothalamus is linked to the immune system in ways not fully understood.

Under stress, humans and animals secrete hormones that put the body on alert, increasing heart rate, blood pressure and respiration. A prolonged hormonal tide, however, could eventually lead to hypertension, kidney disease and a variety of other health problems. A recent Australian study, for exam-

ple, showed that widows and widowers have a higher incidence of infectious disease and death than their contemporaries who have not suffered the severe stress of losing a spouse.

Dr. Hans Selye, pioneer in the field of stress research, has noted that rats under stress secrete large amounts of corticosterone, a hormone from the cortex of the adrenal gland. Normally, corticoids protect the body against inflammation, but a superabundance over a long period of time can reduce immunity to infection.

Another stress-induced change found by Selye and others is a reduction in T-lymphocytes—those white blood cells that play a role in the production of antibodies and initiate an organism's defense against tumors. Researchers have found neurohormones on the surface of T-lymphocytes, so these cells might receive chemical messages from the brain—including messages about stress.

—Dina Ingber

NOTES & QUOTES: Is the venerable New York Times cracking up under the strain? In the 40 years that I've been reading the Times, I've never seen a cartoon strip. But last week the Times had a whole cartoon series on the Reagan economic plan. They even drew up a cover for the series, and here it is, jelly beans and all!



The poor countries of the world are dangerously close to involuntarily defaulting on their \$500 billion in debt to western banks and governments.

A reminder of this grim possibility can be found in a little noticed change in the Depository Institutions and Monetary Control Act of 1980. It also gives an important glimpse of how Americans will pick up the tab for these 100 poor countries so the world's financial system will be saved from a chain of bank failures.

Under the act, the Federal Reserve can purchase the debts of foreign governments, their semi-state agencies and their state enterprises. The Fed becomes the lender of last resort to countries that have temporary liquidity problems, such as Sudan and Brazil. It can mount a rescue operation of foreign governments to prevent them from going insolvent.

Sudan, for example, came the closest of any less-developed country to not paying interest on the \$450 million owed to western banks. For Americans, there are good foreign policy reasons to see that Sudan, a moderate, western-oriented country just north of communist Ethiopia on the strategic Red Sea, remains stable.

With the Russians setting up a naval base in the Dahlak Islands, a part of Ethiopia's troubled Eritrea province, the West must protect friendly countries from both political and economic subversion. A major confrontation could come between the Soviet Union and the United States over access to this region's resources.

But western reaction so far shows mainly a sensitivity to the financial issues and indicates little shift in perceptions about Sudan's eco-

awards." The program went broke with an estimated 8,420 claims that are supposed to be paid by the end of the fiscal year. As an aside, even illegal aliens (by a recent court ruling) were eligible for the California program.

The year 1981 may yet be known as "the year of the bankruptcy." In the first 10 weeks of 1981 business failures rose to 2933, up 63% from last year's 1800. This is the highest number of business bankruptcies since 1963. For the first 11 months of 1980, business bankruptcies hit 10,727, up 52% from 1978.

Americans are more afraid of other Americans than they are of the Russians (and with 25% of our 40 Presidents assassinated or violently attacked, who can blame them). A White House poll of 2,000 citizens shows that only 5% were willing to spend less to fight crime whereas 13% were willing to spend less for defense. After the Reagan shooting, you can bet that the crime fighting votes would be higher!

The following article (from Chicago-Sun Times) is so important that I felt it was worth reprinting here. The implications are mind-blowing, and provide a hint as to why gold may have bottomed at the recent price of 457.

Third world debt is ours International business

Douglas F. Lamont

economic future. Leading banks, including Citibank and Chemical Bank, agree to finance new loans totaling \$60 million subject to one important condition: Sudan must pay \$120 million in overdue interest before April 1. Where will it get the money?

Here's where the Depository Institutions and Monetary Control Act comes in. Once the Sudanese government guarantees its debts—that is, puts its sovereign responsibility behind all principal and interest owed, the Fed will purchase Sudan's bonds.

Their debt becomes America's debt. Through this financial arrangement, the Fed will monetize Sudan's debt, add it to our own money supply, and breed more inflation.

Throughout the third world, government officials are being shown America's new lender-of-last-resort law by commercial bankers. The 1980 Act is the new magic formula for saving these less-developed countries from recognizing that their post-colonial dreams of grandeur are failures.

Once their \$500 billion in debt is monetized by the Fed—that is, brought into our money supply—we will have no hope of solving our inflation problems. The signals from the Sudan and Brazil are grimmer than anyone in Washington has led us to believe.

Douglas F. Lamont is dean of The Walter E. Heller College of Business Administration at Roosevelt University.

California, the Golden State, has a heart of gold. California was the first state in the nation to institute a crime victim's compensation program. Last week the manager of the California program announced "We're out of money for

* *

Speaking of bankruptcies, of the \$27 billion in foreign loans owed by Poland, \$12.7 billion is owed to US banks. Poland is running late on its payments, and the Western banks are not anxious to term the lateness a "default." In fact, 12 US banks just met in London to consider Poland's current request to borrow \$1 billion more to tide them over the current crisis. My own guess as to why Russia is not yet moving into Poland — Russia doesn't want to destroy Poland's credit; Russia wants Poland to continue to be able to borrow from the West. Question: Why is it that no one is ever "called on the carpet" by the banks for making bum loans to defaulting nations? If I make a bum \$50 loan, I hear about it from my wife. If a bank officer makes a bum loan of \$1 billion to Poland — nothing! Who checks Poland's credit at the bank?

* *

Dept. of Unbelievable Statistics: In the last 10 years the Hispanic population of California has risen 92%, the Asian population is up 252%. Of the ten most populous cities in the nation, San Diego is the ONLY one that has more whites than minorities in its public schools.

* *

John Hinckley has a long record of mental disease. He had some psychiatric care. He was turned down by the American Nazi Party as being too interested in violence. He was stopped at an airport with three guns in his satchel, fined \$62 and then set free! He wrote letters to a movie star, and in one letter threatened to kill the President because the President had ignored the star. Society's answer to this sick fellow and his insane actions — "Gun Control."

DEFENSE MYSTERY: Here is the actual and projected US defense budget. 1979 \$117.7 billion; 1980 \$136 billion; 1981 \$162 billion; 1982 \$188 billion; 1983 \$226 billion; 1984 \$225 billion. The Reagan administration is figuring on a DECLINE in inflation from 10% in 1981 to 6% in 1984. BUT if inflation were to stay at only 10% (it is 12% today) the cumulative additions to defense spending would be better than \$25 billion. If inflation increases, the defense additions will be up and off into space.

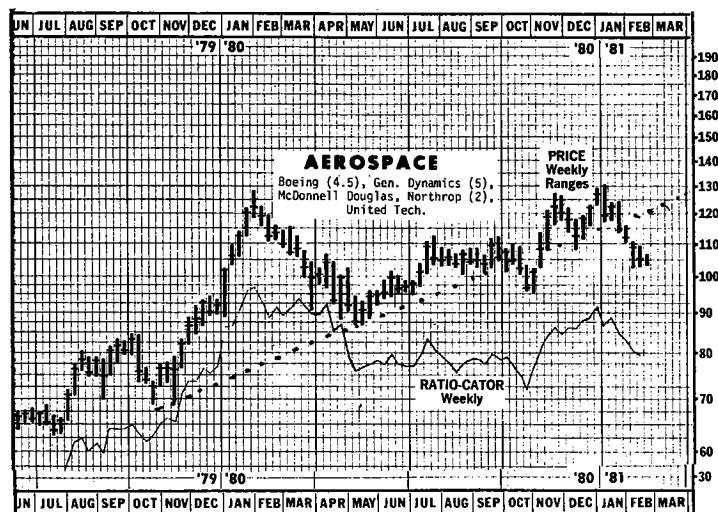
On top of this, the Reagan administration proposes to cut taxes and hold fast or reduce the "butter" side of the guns/butter equation. As Henry Kaufman of Solomon Bros. puts it, *"Never in the past 25 years has the US attempted to raise real defense spending and cut taxes at the same time. The ability of the administration to hold down non-defense outlays will be crucial in containing the budget deficit."*

A number of mysteries present themselves: (1) The administration is going to have to cut back a lot more on non-defense than they have so far if they are to contain the budget deficits. (2) The social programs are where the big spending is. How can the administration cut back without hitting these so-called "sacred" programs? (3) Inflation is not going to come down in the face of whopping and continuing wage increases. (4) My military advisor (Mr. "X") tells me that he sees no major new military spending programs coming on steam. Therefore, where is all the new military spending going to go? My answer is "salaries and pensions." Salaries and pensions already take up 70% of the military budget and they're going much higher!

Conclusion: Watch for massive new budget deficits unless (1) the tax cuts are jettisoned, (2) inflation recedes drastically, (3) social programs are cut dramatically. None of the above are likely to occur. Because of this I predict rocky money markets, continued high interest rates, and poor bond markets.

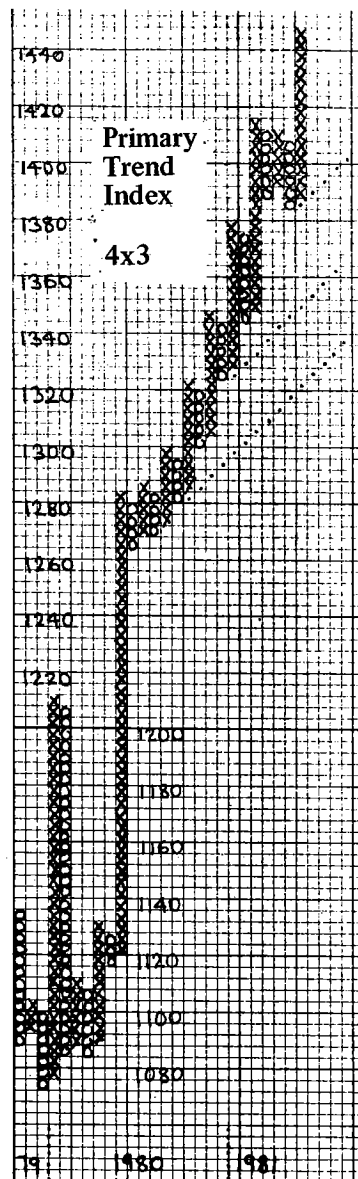
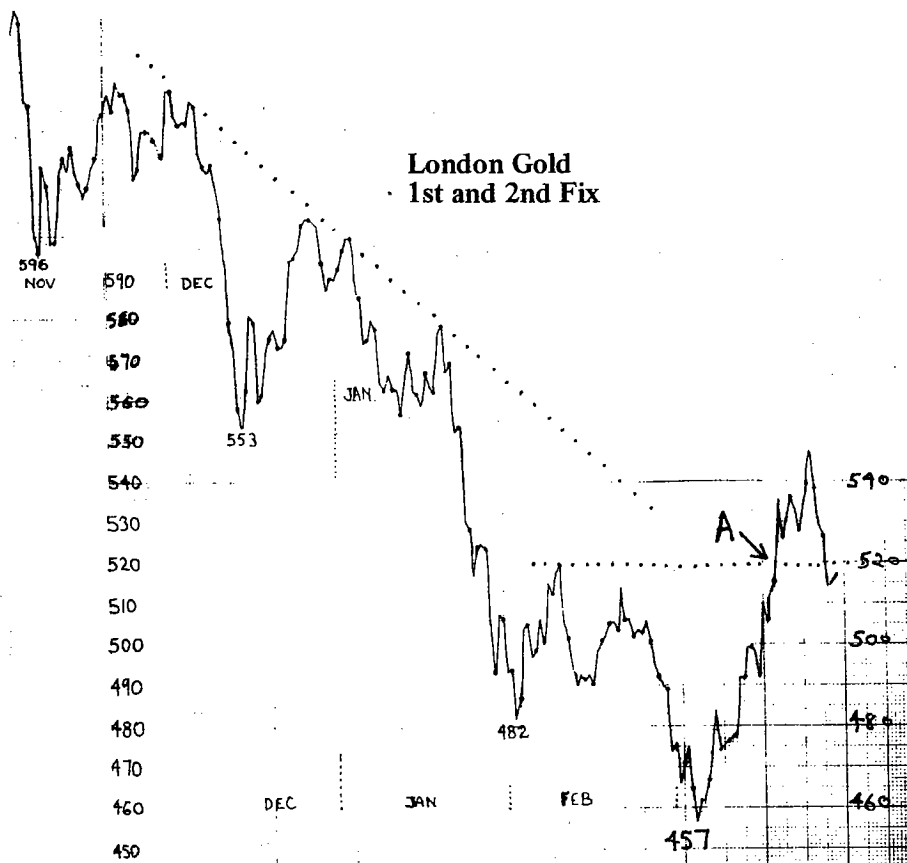
Question: Russell, what are you talking about? How can you say that no major defense programs are coming through. All we hear about is projected "new defense spending."

Answer: Here's a chart of the Aerospace Group. Does this look like an industry readying itself for a big boom? Put it this way — I'm not ready to buy the major defense stocks at this time! (Chart courtesy of *Securities Research*, Boston, MA).



GOLD: I continue to believe that an important bottom is being formed in gold. Turning to the daily chart of gold on page 6, at point A gold spurted above its resistance at 520 due to the news of the Polish crises. Had it not been for Poland, I am reasonably sure that gold would have dropped back from the 520 level (at A) and formed a "right shoulder" in the potential "head-and-shoulders bottom" pattern that is now being traced out.

If gold sinks back to the 490-500 area, I think trading and pilot investment positions in gold and gold funds would be warranted. Should gold sink below 500, it is possible that the low at 457 could be tested — but I don't think that is going to happen. Gold share positions can easily be assumed by buying two funds, ASA on the NYSE and Precious Metal Holding Company (PMH) on the Amex. United Services Fund (a no-load mutual fund) is another easy way to buy gold shares (call 800-531-7510).



LATE NOTES: April 1st was no “fool’s day” unless you happened to be short. On that day the D-J Transports closed at a record high of 439.02, Industrials closed at 1014.14, and Utilities closed fairly strongly at 109.79. The PTI closed at a record high of 1449, and I include a point & figure chart of the PTI so that you can see the relentless strength shown by this indicator.

The S&P 500 and the NYSE Index have still not closed above the January all-time highs, and it seems to me that this phenomenon (plus the still-lagging A-D ratio) is keeping the bears’ hopes alive. The old adage states that “a bull market climbs a wall of worry.” It seems to me more and more that this market is climbing a wall of technical problems. Every day this market provides something to keep the bears hoping and the short sellers intact. But the fact is that the market continues to plow ahead, and my PTI has faithfully measured this relentless positive technical strength.

IF the major composite Averages burst through their January, 1981 highs, I think there is a potential for a “running of the shorts.” In that case, we could see an upward spike into the early-May period. Remember (see Letter 805, page 2) that in early May the bear segment of my 233-day cycle takes over. The bear segment takes approximately 89 days. Until then, it would seem to be “torture time” for the shorts.

NEXT MAILING: April 22